



Non-Wage Withholding P.L. 109-222 § 511

- *Requires 3 percent federal income tax withholding on vendor payments*
- *Takes effect January 1, 2011*
- *Does not apply to the private sector; only applies to federal, state and local governments that spend at least \$100 million per year on products and services*
- *Unfunded mandate slipped into final version of tax bill without hearing or consultation*
- *Costs include system programming, staffing, reporting and price increases from vendors*

County News

National Association of Counties
Washington, D.C.
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Counties: Uncle Sam wants you to collect federal taxes

By ALYSOUN McLAUGHLIN
ASSOCIATE LEGISLATIVE DIRECTOR

The federal government is conscripting your county personnel into serving as federal tax collectors.

A new law may soon require your county to withhold 3 percent of nearly every payment to a vendor or contractor and send it to the federal government. According to Miriam Singer, director of procurement for Miami-Dade County, the new requirement — which applies to county purchases of everything from plumbing services to paper clips — amounts to “taxing local governments to subsidize the federal budget.”

That is, of course, the point of this new requirement. The overall price tag on the tax bill signed into law in May was capped for procedural reasons at \$70 billion. The House of Representatives insisted on including a \$50 billion extension of the current tax rate on capital gains and dividends while the Senate insisted including a \$30 billion “patch” on the Alternative Minimum Tax. To pay for including both in the final bill, conferees slipped a package of revenue raisers including this provision into the bill just prior to House and Senate passage, leaving no time for organized opposition.

Indeed, the Joint Committee on Taxation believes that counties, cities, states and federal procurement officers will collect more than \$6 billion in taxes that government contractors and vendors would not otherwise have paid to the IRS in FY11.

Members of Congress have discovered that thousands of Pentagon contractors owe more than \$3 billion in taxes to the federal government. Rather than simply enforcing the law against these contractors or imposing a new withholding requirement on contracts with the federal government, this new requirement will apply to states



and any local government that spends more than \$100 million per year on purchases of goods and services. Smaller cities and counties are exempt.

Counties will receive no compensation for providing this service to the federal government but will be required to spend millions to upgrade accounting software and hire staff to do the job of IRS auditors.

Christine Cohen, auditor-controller for Ventura County, Calif., said it is too soon to assess the dollar impact but, “I am sure that with the system programming changes, reporting requirements, staffing allocations and new deadlines, we would also be faced with price increases from vendors, adding to the cost of government projects.”

Since the requirement only applies to the public sector — not private purchasers — Cohen is not alone in her concern that this new law will place counties at a competitive disadvantage in purchasing products and services. According to budget director Dawn Jindrich, Linn County, Iowa “already [has] trouble getting contractors to bid on some of our projects because of the additional requirements related to government contracts. This will make it even more difficult to do competitive bidding.” Jindrich also questioned the logic of the requirement since many of the county’s



contractors are Subchapter S corporations that are already required to pay quarterly estimated taxes.

Tim Firestine, finance director for Montgomery County, Md. pointed out that counties already send a form 1099 to the IRS for payments in excess of \$600 and questions why that is insufficient for the IRS to track down any vendor that does not pay their taxes.

Gary Malmgren, chief accountant for Contra Costa County, Calif. said a number of unanswered questions remain. For example, the law does not spell out how the county will report withheld amounts to either payees or the IRS, how often payments must be sent, or what penalties might apply to late payments or inaccurate reporting. He also ques-

tioned how it might apply to payments made through a third-party credit card bank.

Congressional staff familiar with the conference negotiations indicate that members of Congress intentionally applied the requirement to credit card payments to avoid creating a loophole, and for the same reason did not exempt small transactions from the requirement. However, they suggest that counties, cities and states might be able to work with the Treasury Department to determine a threshold to ease administrability without creating a loophole.

Congress did exempt certain payments from the law — specifically payments for interest and real property, payments to other governments, nonprofit entities or government employees, and payments in

connection with a means-tested public assistance program or pursuant to a classified or confidential contract.

These exemptions may drive up costs, however, precluding automatic transaction coding and requiring county personnel to review individual transactions to determine whether they classify.

Sen. Larry Craig (R-Idaho) has introduced legislation to repeal this unfunded mandate on state and local governments as well as the withholding requirement for federal government vendors and contractors. NACo is working with his staff and is exploring options for repealing or mitigating the costs of this unfunded federal mandate.

National Association of Counties

NACo Legislative Department — Edwin S. Rosado, Director

Repeal New Non-Wage Withholding Requirement

Issue: New requirement that counties that spend more than \$100 million annually on products and services serve as tax collectors for the federal government by withholding and remitting 3% of most payments for products and services for federal income tax purposes.

NACo policy: NACo opposes unfunded mandates on counties and demands meaningful involvement by county officials in federal decisionmaking.

Action needed: County officials should urge immediate repeal of the unfunded mandate in Section 511 of P.L. 109-222. County officials should provide as much specific information as possible on the anticipated cost.

Background: SH.R. 4297, the "Tax Increase Prevention and Reconciliation Act of 2006", was signed into law as P.L. 109-222 on May 17, 2006. Major provisions of the law extended the 15% tax rate on capital gains and dividends and prevented an increase in the number of taxpayers subject to the Alternative Minimum Tax. Section 511 of the law creates a new withholding mechanism for payments to government vendors and contractors.

Section 511 did not appear in either the original House or Senate version, but was inserted by a conference committee seeking to offset the cost of tax cuts sought by both the House and the Senate. The provision will raise \$7 billion for the federal government between 2011 and 2015 by requiring any jurisdiction that spends more than \$100 million per year on goods and services to withhold 3% of most payments to vendors and contractors. The requirement only applies to states and local governments, not the private sector.

Withholding will be required, beginning January 1, 2011, for any payment - regardless of the amount or form of the transaction - to purchase any product or service other than interest or real property. No vendor or contractor is exempt except other governments or nonprofit entities and government employees. Payments made in connection with a public assistance program based upon need or income or pursuant to a classified or confidential contract are exempt. Further details will be determined by the U.S. Department of the Treasury.

The Congressional Budget Office and the Joint Committee on Taxation have indicated that the costs of this intergovernmental mandate exceed the threshold specified in the Unfunded Mandates Reform Act (\$62 million per year in 2006, adjusted annually for inflation). County officials indicate that this requirement will be extremely expensive to implement. In many cases it will require programming changes to financial and accounting systems and the hiring of additional staff. Many county officials are also concerned that it will discourage contractors from bidding on government products and increase pricing.

This unfunded mandate is particularly egregious because it was added to the final version of legislation without any consultation with state and local government officials or their national organizations.

For further information, contact: Alysoun McLaughlin 202/942-4254 or
amclaughlin@naco.org
June 2006

NACo FACT SHEET

Government Withholding Relief Coalition

July 11, 2006

The Honorable Larry Craig
United States Senate
Washington, D.C. 20510

Dear Senator Craig:

The *Government Withholding Relief Coalition* and its member organizations listed below strongly support your legislation, S. 2821, the Withholding Tax Relief Act of 2006. This important legislation would repeal section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222). Section 511 is a sweeping new requirement mandating that federal, state, and local governments withhold 3-percent from payments for goods and services. This new tax withholding requirement affects all government contracts as well as any payment to any person for a service or product provided to a government entity.

We are deeply concerned about the impact and the unintended consequences of this provision on all companies that receive contracts or other forms of payment from the government. Among other concerns, the withholding is based on revenues from government payments with no relationship to a companies' taxable income and will impinge on company cash flows needed for day-to-day operations. In addition, the costs to governments at all levels to administer the program will be substantial and the process exceedingly complicated to implement.

The *Government Withholding Relief Coalition* and its member organizations appreciate your leadership on the effort to repeal the withholding requirement and look forward to assisting you on this issue. We are committed to working with Congress to rescind this harmful provision.

Sincerely,

Government Withholding Relief Coalition

- Aerospace Industries Association
- Air Transport Association
- American Congress on Surveying and Mapping
- American Council of Engineering Companies
- American Institute of Architects
- American Road & Transportation Builders Association
- American Shipbuilding Association
- Associated Builders and Contractors
- Associated General Contractors of America

- Coalition for Government Procurement
- Construction Management Association of America
- Contract Services Association
- Electronic Industries Alliance
- Federation of American Hospitals
- Financial Services Roundtable
- Financial Executives International Committee on Taxation
- Information Technology Association of America
- Management Association for Private Photogrammetric Surveyors
- Mason Contractors Association of America
- National Association for the Self-Employed
- National Association of Credit Management
- National Association of Manufacturers
- National Defense Industrial Association
- National Federation of Independent Business
- National Italian-American Business Association
- National Society of Professional Engineers
- National Society of Professional Surveyors
- Plumbing-Heating-Cooling Contractors - National Association
- Printing Industries of America
- Professional Services Council
- National Roofing Contractors Association
- The Design Professionals Coalition
- Small Business & Entrepreneurship Council
- U.S. Chamber of Commerce
- USTelecom Association
- Women Impacting Public Policy

Government Withholding Relief Coalition

Senator Craig recently S. 2821, the Withholding Tax Relief Act of 2006, on May 17, 2006. This important piece of legislation would repeal section 511 of the recently-enacted Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222). This provision is a sweeping new requirement mandating a 3-percent tax withholding on all payments to contractors for goods and services provided to federal, state, and local governments.

This withholding provision is seriously flawed and should be reconsidered for the following reasons:

- **Hits honest taxpayers in an attempt to get the tax cheats.** Honest companies already pay their taxes on time. The provision forces contractors to provide the government an interest-free loan. It uses a sledgehammer to resolve a tax compliance problems caused by a small minority of government contractors.
- **Fewer types of firms will be able to bid on government contracts leading to higher costs to the government.** The withholding provision is based on a company's revenue. Companies with tight margins or irregular cash flows would lose vital funds needed for day-to-day operations and would be at a competitive disadvantage in the bidding process. Fewer competitive bids could translate to higher costs to the government.
- **Increases the cost of doing business with all levels of government.** Many contractors may have to take on higher levels of debt or equity in order to ensure regular cash flows necessary for operations. The cost of this increase in capital structure may be passed on to the government through increased price of goods and services and may ultimately be paid by the taxpayer.
- **\$7 billion solution when the actual problem is only \$200 million per year.** The provision is aimed at collecting underreported tax revenues by government contractors, which would raise approximately \$200 million a year. The large bulk of the estimated savings of \$7 billions dollars is simply an accounting gimmick. The reason being is that the way the provision is set up the government is paid for annual taxes twice in the first year of the provision (2011).
- **Is potentially an unfunded mandate on state and local governments.** Federal tax compliance enforcement is the function of the IRS and this program would increase the costs to states significantly. The cost to administer programs could be substantial.
- **This is the first time the federal law has imposed withholding a portion of revenues from a sales transaction between any entity and its customers for potential future tax liability.** The new withholding provision is based on a company's revenue not net income. Thus the arbitrary 3% withholding will not be a good indicator of tax liability if any. As a result, companies operating with high volumes and small profit margins would have to loose vital funds needed to operate day to day activities.



Local officials seek to reverse withholding law

Reuters

WASHINGTON - State, city and county officials are marshaling forces to try to reverse a new tax law provision that will require them to withhold billions of dollars from contractors to help boost federal tax collections.

The provision, inserted in the \$70 billion tax-cut extension act by U.S. Senate and House of Representatives conferees in May, came as a surprise to state and local officials, who say it will burden them with big compliance costs and higher prices for goods and services.

States, cities, counties and other governmental agencies with annual goods and services expenditures of over \$100 million will have to withhold 3 percent of payments for those purchases, starting in January 2011. Suppliers and contractors can recoup these funds after they pay their federal taxes.

By helping to close the gap between taxes owed and taxes paid, the Senate Finance Committee estimates that the provision will raise federal revenues by \$6.98 billion over 10 years.

Finance directors are busy trying to sort out how they can comply and add up the costs.

"It would be one more thing that we're required to do by the federal government for which we get no financial support. You could call it an unfunded mandate," said Sharon Whitmore, assistant finance director for Fulton County, Georgia, home to Atlanta.

"It may cost us more to do business, because companies might just tack more onto their bids to cover their costs from the withholding," she said.

Smaller localities also are trying to determine if their budgets will grow to a level that will exceed the withholding threshold by 2011. The National Association of Counties anticipates that many counties with smaller direct expenditure budgets will be put over the threshold if they have county-run hospitals, nursing homes or school systems.

Payments under the Medicare program will be subject to the withholding, but payments under Medicaid and other means-tested welfare programs will be excluded.

LOBBYING EFFORTS

Local officials also are working to make sure their congressmen are aware of the provision, which was not voted on by either the House or the Senate.

"This bill is an unfair and intrusive attempt to address the tax noncompliance of a few vendors by penalizing all vendors as well as the state and local governments with whom they do business," wrote Connecticut Comptroller Nancy Wyman in a letter to Sen. Christopher Dodd, a Connecticut Democrat.

Idaho Sen. Larry Craig, a Republican, has introduced a bill that would repeal the provision, which he said bucks the Internal Revenue Service's collection responsibilities to the taxpayers.

However, the Senate Finance Committee, which has jurisdiction over tax legislation, has yet to schedule a hearing on the bill.

Chris Braddock, associate director for procurement and privatization policy at the U.S. Chamber of Commerce, said he does not expect the bill to be considered before Congress takes its election-year recess in August.

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June 19, 2006

Dear Member of Congress:

I am writing to urge immediate repeal of a costly new unfunded mandate on local governments. Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) will soon require counties to withhold payments from nearly all vendors and contractors for federal income tax purposes. **In effect, this new law conscripts county personnel into serving as tax collectors for the federal government.**

The Congressional Budget Office and the Joint Committee on Taxation have determined that this requirement is an intergovernmental mandate that exceeds the threshold specified in the Unfunded Mandates Reform Act. Costs for county governments will be significant and will include reprogramming or purchasing new accounts payable systems to capture and account for the required withholding as well as hiring new county employees for coding transactions and performing reconciliation and reporting. In addition, this provision will likely place a chill on competitive bidding, drive up the cost of public sector procurement and increase the burden on county taxpayers.

This unfunded mandate is particularly abhorrent because it was slipped into the conference report just prior to the final vote with no consultation with state or local government officials. **We urge you to seek its immediate repeal.**

If you have any questions about the impact of this new law on county governments in your state or district and across the nation, contact me or Associate Legislative Director Alysoun McLaughlin at 202-942-4254 or amclaughlin@naco.org. Thank you for your attention to this urgent matter.

Sincerely,

A handwritten signature in cursive script that reads "Larry E. Naake". The signature is written in black ink and is positioned above the printed name and title.

Larry E. Naake
Executive Director

**National Association of Counties
National League of Cities
Government Finance Officers Association**

May 17, 2006

The Honorable Larry Craig
United States Senate
520 Hart Senate Office Building
Washington, D.C. 20510-1203

Dear Senator Craig:

We write to express our appreciation for your remarks on the floor of the United States Senate during consideration of H.R. 4297, Tax Increase Prevention and Reconciliation Act of 2005 and to pledge our support for repealing the unfunded mandate on local governments that will take effect under that law on January 1, 2011.

We are grateful for your concern that the withholding provision inserted into the conference report will impose an unfunded mandate by driving up costs for local governments. In fact, the Joint Committee on Taxation and the Congressional Budget Office have jointly determined that the provision is an intergovernmental mandate exceeding the threshold specified in the Unfunded Mandates Reform Act (\$64 million for 2006, adjusted annually for inflation).

We look forward to working with you to repeal this provision. For assistance from our organizations on this issue, please contact Alysoun McLaughlin with the National Association of Counties (202-942-4254/amclaughlin@naco.org), Alex Ponder with the National League of Cities (202-626-3028/ponder@nlc.org) or Susan Gaffney with the Government Finance Officers Association (202-393-8020/sgaffney@gfoa.org).

Sincerely,

Larry E. Naake
Executive Director
National Association of Counties

Donald J. Borut
Executive Director
National League of Cities

Jeffrey L. Esser
Executive Director
Government Finance Officers Association

109TH CONGRESS
2D SESSION

S. 2821

To repeal the imposition of withholding on certain payments made to vendors by government entities.

IN THE SENATE OF THE UNITED STATES

MAY 17, 2006

Mr. CRAIG introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To repeal the imposition of withholding on certain payments made to vendors by government entities.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Withholding Tax Relief
5 Act of 2006”.

6 **SEC. 2. REPEAL OF IMPOSITION OF WITHHOLDING ON CER-**
7 **TAIN PAYMENTS MADE TO VENDORS BY GOV-**
8 **ERNMENT ENTITIES.**

9 The amendment made by section 511 of the Tax In-
10 crease Prevention and Reconciliation Act of 2005 is re-

1 pealed and the Internal Revenue Code of 1986 shall be
2 applied as if such amendment had never been enacted.

○

Excerpt from Public Law 109-222

**SEC. 511. IMPOSITION OF WITHHOLDING ON CERTAIN PAYMENTS
MADE BY GOVERNMENT ENTITIES.**

(a) In General- Section 3402 is amended by adding at the end the following new subsection:

`(t) Extension of Withholding to Certain Payments Made by Government Entities-

`(1) GENERAL RULE- The Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies) making any payment to any person providing any property or services (including any payment made in connection with a government voucher or certificate program which functions as a payment for property or services) shall deduct and withhold from such payment a tax in an amount equal to 3 percent of such payment.

`(2) PROPERTY AND SERVICES SUBJECT TO WITHHOLDING-

Paragraph (1) shall not apply to any payment--

`(A) except as provided in subparagraph (B), which is subject to withholding under any other provision of this chapter or chapter 3,

`(B) which is subject to withholding under section 3406 and from which amounts are being withheld under such section,

`(C) of interest,

`(D) for real property,

`(E) to any governmental entity subject to the requirements of paragraph (1), any tax-exempt entity, or any foreign government,

`(F) made pursuant to a classified or confidential contract described in section 6050M(e)(3),

`(G) made by a political subdivision of a State (or any instrumentality thereof) which makes less than \$100,000,000 of such payments annually,

`(H) which is in connection with a public assistance or public welfare program for which eligibility is determined by a needs or income test, and

`(I) to any government employee not otherwise excludable with respect to their services as an employee.

`(3) COORDINATION WITH OTHER SECTIONS- For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, payments to any person for property or services which are subject to withholding shall be treated as if such payments were wages paid by an employer to an employee.'

(b) Effective Date- The amendment made by this section shall apply to payments made after December 31, 2010.

